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SUBJECT: TURKEY: IMPORTANT, BUT TENTATIVE, STEP ON NATURAL
GAS SECTOR LIBERALIZATION

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1. (SBU) Summary: In a possible step forward on long-delayed gas sector liberalization, the Turkish State Pipeline Company BOTAS announced a tender for six of its natural gas import contracts in November. Although legal obstacles may eventually require that the tender be switched to gas volumes, rather than contracts, the companies now expressing interest seem to be positioning themselves for that next step. In the context of President Putin's visit December 5-6, the press has reported widely on Russian interest in investment in natural gas distribution and transit in Turkey. End Summary.

Legal Framework

2. (SBU) The 2001 Natural Gas Market Law requires BOTAS to gradually transfer its gas import responsibilities to the private sector through a program of tendering contracts between BOTAS and foreign suppliers, such as Russia's Gazprom and Iran's NIGC. Under the arrangement, BOTAS was supposed to transfer 10% of its total contract amounts each year starting from 2002, targeting a market share of 20% by 2009. However, BOTAS has so far failed to transfer any contracts to the private sector, claiming it was impossible due to confidentiality and take-or-pay clauses in the agreements and the likely reluctance of suppliers to release sovereign guarantees. In July 2004, the GOT submitted a new draft law to the Parliament that would have amended the 2001 law in support of BOTAS' position, and also aimed at maintaining BOTAS' monopolistic structure. The private sector harshly criticized the draft and succeeded in having the GOT withdraw it from the Parliament.

3. (SBU) In response to private sector urging and a recent EU Progress Report's recommendations, the GOT decided to go ahead with the contract transfer tender, even though a World Bank report on the gas sector supported a switch to a "gas volume release" model whereby entirely new lot contracts would be negotiated between foreign gas suppliers and private Turkish importers. BOTAS tendered a total of 16 BCM of its gas imports from Nigeria, Algeria, Iran and Russia, corresponding to 64% of Turkey's 25 BCM natural gas consumption projection for 2005. Even if the actual transfer of the contracts does not work out due to legal obstacles or lack of approval from suppliers, tender participants may expect their interest in contract transfer to position themselves for a likely switch to bidding on gas volume lots.

BOTAS Perspective

4. (SBU) In a meeting with Econoff and Econ Specialist on October 6, BOTAS Natural Gas Purchase Director Arif Akturk criticized the 2001 Natural Gas Market Law for setting unrealistic targets. Akturk cited several problems related to the contract transfer model stipulated by the law. First, he said that since most of the contracts were based on inter-governmental agreements -- "non-disputable" by law -- suppliers would not be willing to give up their sovereign guarantees and re-negotiate their contracts with a new private entity. Akturk stated that the take-or-pay liabilities in long-term contracts were another major problem for potential private sector buyers. The BOTAS Director was more optimistic about switching to the alternative of "gas volume release", whereby BOTAS would keep its contracts with its suppliers and sign a separate contract with private companies.

Private Sector Interest

5. (SBU) Press reports claimed several international and domestic energy companies, including BP, Shell, Statoil, Unit International, Koc Group, Sabanci Group and Bosphorus Gas, were interested in BOTAS' contract transfers. Econoff and Econ Specialist met with Shell Turkey Director Nusret

Comert on November 9 to discuss the gas tenders. Comert confirmed his company's interest in BOTAS' gas release, but thought volume release would be a more realistic method than contract transfer. Comert fully supported the GOT's stated goal of liberalizing its gas sector, but thought that reducing the state import share to 20% in a few years was an extremely ambitious target for any country. Comert believed BOTAS was likely to fail in transferring its gas contracts with this tender, but noted the possible exception of Bosphorus Gas, in which Gazprom has a 40% ownership share. He observed this could offer it an advantage in the three export contracts with Gazprom tendered by BOTAS. (Note: BOTAS requires potential bidders having existing relations with any one of BOTAS' suppliers to receive the Competition Authority's approval to participate in the tender. Sector representatives comment the Competition Authority would not have a problem approving Bosphorus Gas. End Note)

16. (SBU) In a separate meeting, BP Business Development Director Oktay Sen identified several uncertainties and potential legal problems with respect BOTAS' tender, so BP had not yet decided to participate in the tender. Sen commented that an apparent BOTAS requirement for companies to bid for the contract transfer tender in order to be able to participate in potential subsequent volume release process was unusual and problematic. Moreover, Sen said that in effect the current tender is explicitly for the "right to negotiate" with BOTAS' purchase contract partners (i.e., Russia) without knowing specific contract terms.

The Russians are Coming

17. (SBU) The tender announcement comes against the backdrop of the December 5-6 visit of President Putin. Embassy contacts and the press have noted Russian interest in signing a MOU with BOTAS expressing Gazprom's intention to invest in Turkey's energy sector given its current gas sales, specifically in natural gas distribution, gas storage, gas transmission within and beyond Turkey, and a potential LNG terminal in Ceyhan. BOTAS' Akturk said Gazprom's taking over a significant portion of BOTAS' gas imports from Russia, possibly through participation in multiple companies, could pose risk of undue influence in the market. The World Bank report notes the possibility of unfair competition by Gazprom - the world's largest gas producer, which has developed a strategy for expanding downstream into European gas markets. While Gazprom has shown flexibility in revising existing take-or-pay contracts with Turkey, Russia may view its economic interests to be compromised by the development of alternative gas transit projects across Turkey.

18. (SBU) Comment: The gas tender announcement constitutes a concrete step in the right direction. Despite confusion and criticism with respect to BOTAS' two different gas release models, there seems to be considerable interest from companies. As existing dominant gas supplier, Russia is a natural partner for opening up Turkey's gas market. Turkey's regulatory and competition bodies will have to remain vigilant to safeguard the transition to healthy competition and to avoid undue influence from the dominant supplier Gazprom. End Comment.

Edelman